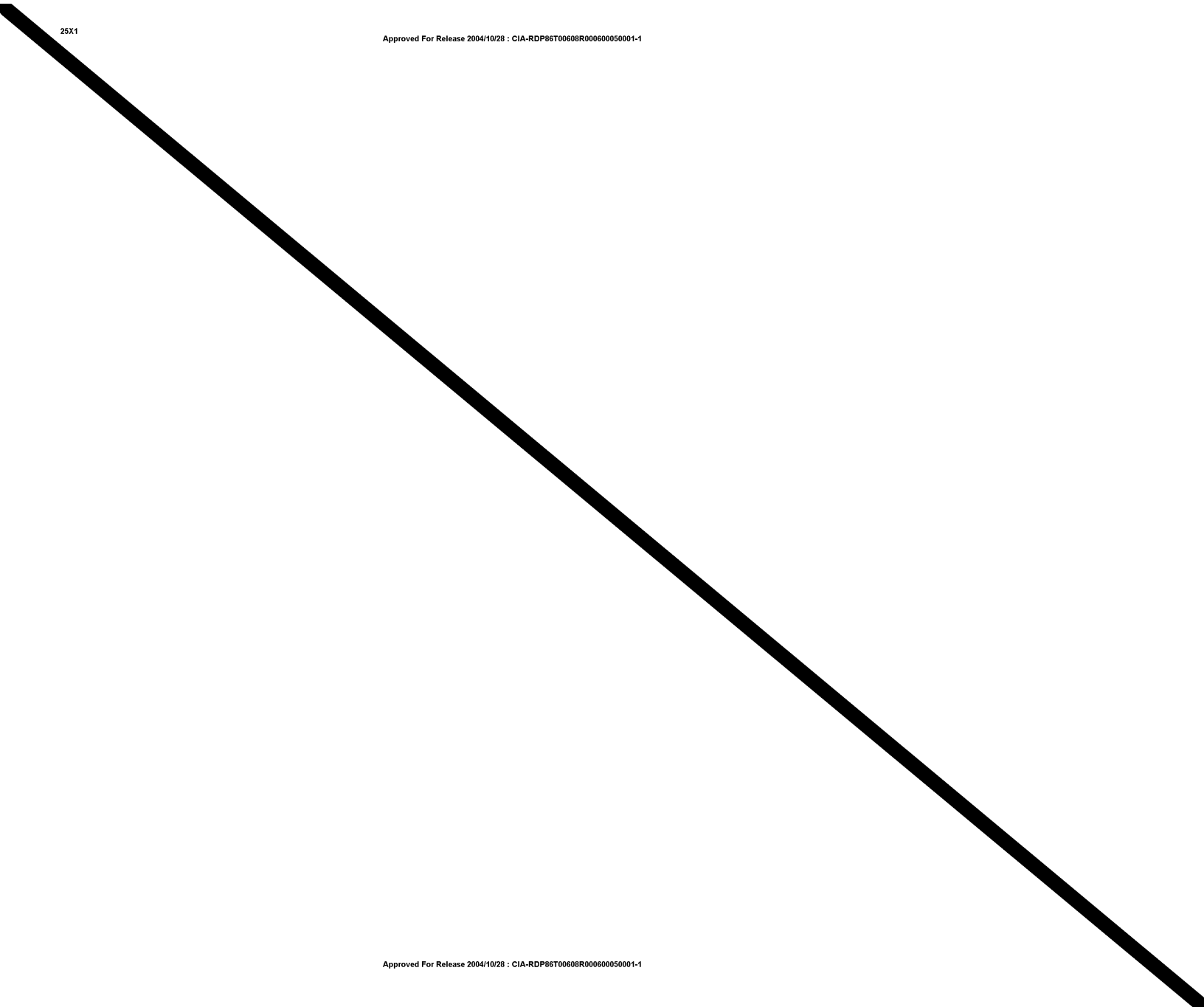

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S-07636

19 SEP 1975

CIA/OER/S-07636-75

MEMORANDUM FOR: [redacted] 25X1

SUBJECT : Multinational Corporations and Developing Countries

1. Per your phone request of 4 September 1975, we have made a quick search of the literature on multinational corporations (MNCs). We believe that the four items enclosed provide the information you desire. The first enclosure is a brief tabulation of our judgement as to the probable economic effects of MNCs on less developed host countries. The second is a study done by [redacted] of our office. 25X1
The third is an excerpt from Dr. Raymond Vernon's book on MNCs, and the fourth is an excerpt from a United Nations study.

2. We believe that these three enclosures present a balanced look at the impact of MNCs. [redacted] study 25X1
looks at the theoretical impact of MNCs on all host countries, both developed and developing. The latter two deal specifically with the impact of MNCs on LDCs. Dr. Vernon's book probably has a slight bias toward the favorable effect of MNC; the UN study is biased somewhat in the opposite direction.

3. If you have further questions, please call Mr. 25X1
[redacted]

25X1 [redacted]

Acting Chief
Western Europe Branch
Industrial Nations Division
Office of Economic Research

MICRO ONLY

Attachment
As stated:

[redacted] 25X1

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[redacted] 25X1

25X1

## SUMMARY OF PROBABLE EFFECTS BY MNCs ON HOST COUNTRIES

| Area of Impact | Direction of Effect |
|---|---|
| Employment | Positive |
| Income Level | Positive |
| Tax Revenues | Positive |
| Balance of Payments | Positive at first but possible negative in later years (except for investments in resource extraction) |
| Income Distribution | Negative |

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# SOVEREIGNTY AT BAY

## *The Multinational Spread of U.S. Enterprises*

BY

RAYMOND VERNON

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NEW YORK / LONDON

spread disposition on the part of government authorities in the advanced countries to assume that harmful responses are common; indeed, the contrary view is often expressed in official circles. But the existence of options, irrespective of whether or how the options are exercised, is disconcerting for some countries, especially for those that are accustomed to a sense of control.[25]

## *The Less-Developed Areas*

The eighty or so less-developed countries of the world come in all shapes and sizes, and their cultural and historical backgrounds present extraordinary variety. Nevertheless, the standards by which they are prone to judge the effects of investment by multinational enterprises have a striking uniformity. What is more, the standards are not unlike those that the more advanced host countries tend to apply; the differences are largely those of emphasis. Those differences in emphasis, however, can produce spectacularly different judgments regarding the effects of the enterprises.

### THE MOBILIZATION OF RESOURCES

If the resource transfer of U.S.-owned multinational enterprises to the less-developed countries were measured simply in terms of long-term capital movements, the activities of these enterprises would be counted as only marginally important in the less-developed world. The direct investment flow from the United States to the less-developed areas during the 1960s, for instance, came to less than $1 billion annually. This is a modest sum when compared with such yardsticks as annual gross capital formation in the less-developed countries, amounting to about $35 billion in the middle of the decade, or annual international resource flows to these countries of about

### *National Economic Consequences*

$12 billion. But these foreign-owned subsidiaries were much more than conduits for foreign capital; they were mobilizers of local resources, as well as collectors and organizers of people and information. For less-developed economies, where local institutions for the mobilization of resources were generally not very strong, this function had a significance all its own.

The degree of mobilization of resources by U.S.-owned subsidiaries is suggested by the fact that for every dollar of capital transferred from the United States to these subsidiaries in the less-developed countries, about $4 more of capital were collected by the subsidiaries from other sources, including sources internal to the less-developed areas.[26] While the subsidiaries employed about 26,000 U.S. nationals, they also had 3 million or so locally recruited employees.[27] As usual, however, the intangibles are probably the most important assets of all: information on production and marketing techniques; a commitment to the creation of a local organization; a capacity, efficient or otherwise, to search out needed inputs in the local economy or abroad.

In theory, the impact of these subsidiaries could be measured by the economic yardstick of relative productivity. In practice, it is next to impossible to find a statistical basis that allows a plausible comparison to be made. Local competitors are sometimes prepared to agree—indeed, to insist—that the productivity of foreign-owned subsidiaries exceeds their own. But in explaining the difference they tend to stress such factors as the foreign subsidiary's access to credit or its use of well-established trade names.* These factors, they argue, lead to higher sales and less variable sales than those of the local competition, thereby making

* Consistent with this view is evidence in W. J. Bilkey, *Industrial Stimulation* (Lexington, Mass.: Heath Lexington Books, 1970) p. 172. Bilkey demonstrates that in El Salvador the obstacles perceived by local entrepreneurs and those perceived by foreign-owned enterprises, when contemplating the expansion of production, were quite different. The local firms were widely concerned about the availability of credit, whereas the foreign-owned firms were much less concerned on that score.

for lower unit costs. This issue, therefore, sits in limbo until better figures can be produced. There are other fundamental issues, however, on which more can be said. One of these is the balance-of-payments impact of a foreign-owned subsidiary.

### BALANCE-OF-PAYMENTS EFFECTS

The balance-of-payments issue is far more important for the less-developed areas than for the advanced countries. In the advanced countries, the need for foreign exchange varies considerably according to countries and to periods. For the less-developed areas, however, foreign exchange is widely regarded as a scarce resource that chronically inhibits growth.

The prevailing view in developing countries is that foreign-owned subsidiaries decapitalize the country that plays host to them; their operations are said on balance to reduce the supply of funds available for investment in the country and to burden the national balance of payments. The demonstration is simple enough: From 1960 to 1968, when approximately $1 billion of fresh capital was being transferred annually to U.S.-controlled subsidiaries in the less-developed areas, approximately $2.5 billion was being withdrawn annually in the form of income alone.[28] If withdrawals in the form of royalties and of the overpricing of intermediate goods were added, the figure would be still larger. The case for the decapitalization thesis, therefore, may seem fairly vigorous.

However, it takes only a moment's reflection to realize that figures of this sort are quite misleading, at least to the extent that they purport to measure balance-of-payments impact. Implicitly, the figures assume that the only balance-of-payments effect of the foreign-owned subsidiaries' operations is capital inflows and remission outflows. In reality, as was noted earlier, the presence of the foreign-owned subsidiary has an impact on every item in the balance-of-payments accounts.

The Treasury Department study throws some light on that



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impact.[29] The balance-of-payments estimates, shown in Table 5–2, prove strikingly different from the popular generalizations on the subject. They offer only slight encouragement to the school that sees foreigners' direct investments as the answer to the foreign exchange shortages of these countries. And they offer no comfort at all to the school that sees foreign direct investment as a balance-of-payments drain.

In model A, it will be remembered, the U.S. investor is assumed to have a free choice in deciding whether to serve his market by means of a local subsidiary. In Latin America, his decision to invest in such a subsidiary is seen as generating a small positive payments balance for the host country during the first year after the investment, and a slightly larger positive balance during the tenth year. In other less developed areas, the positive results are somewhat larger. However, this positive outcome comes mainly from the assumption in the model that the effect of the investment is to displace imports from the United States with local production. In model B, where this assumption is absent, investment in Latin America loses foreign exchange for the host country, whereas in other less-developed areas there is a gain of foreign exchange.*

The main point of interest to be extracted from the two models is that the profits, royalties, and fees paid to the U.S. parent turn out to be much less important in determining the net balance-of-payments influence of the U.S. investment than does the import-substituting assumption.†

* The models fail to deal explicitly with the case in which the investment would be undertaken by another foreign enterprise if it had not been undertaken by a U.S. enterprise. The results of such a calculation would presumably come close to model B, however.

† There is a real question whether the profits and royalties figures are accurately reflected in the table. Subsidiaries are not required to pay for the services of parents in some cases. In others, high transfer prices on imports from the parent or affiliates may reduce local profits. In that case, the elevated prices would be captured in the import data, but the offset would not be perfect, owing to tax effects.

TABLE 5-2

*Two Models of Balance-of-payments Impact on Less-developed Countries from Transactions with the United States Associated with $1.00 of Direct Investment in U.S.-controlled Manufacturing Subsidiaries (based on data of the early 1960s)*

| | IMPACT ON LATIN AMERICA (IN U.S. CENTS) | | IMPACT ON AREAS OUTSIDE CANADA, EUROPE, AND LATIN AMERICA (IN U.S. CENTS) | |
|---|---|---|---|---|
| | FIRST YEAR AFTER | TENTH YEAR AFTER | FIRST YEAR AFTER | TENTH YEAR AFTER |
| Model A: The free choice investment[a] | | | | |
| Income, royalties, fees to United States | −5.4 | −9.0 | −10.2 | −23.0 |
| Net replacement of imports from United States | +37.4 | +62.5 | +84.1 | +190.5 |
| Other trade effects with United States | −19.3 | −32.3 | −18.9 | −43.0 |
| Total effects with United States | +12.7 | +21.2 | +55.0 | +124.5 |
| Model B: The defensive investment[a] | | | | |
| Income, royalties, fees to United States | −5.4 | −9.0 | −10.2 | −23.0 |
| Net replacement of imports from United States | −7.5 | −12.6 | +22.5 | +51.0 |
| Other trade effects with United States | +2.9 | +4.9 | −3.0 | −6.7 |
| Total effects with United States | −10.0 | −16.7 | +9.3 | +21.3 |
| Total sales by subsidiaries | 92.0 | 154.0 | 111.0 | 251.3 |

[a]See the text, p. 164, for the differences in the assumptions embodied in the models.

*Source:* G. C. Hufbauer and F. M. Adler, U.S. Treasury Department, *Overseas Manufacturing Investment and the Balance of Payments* (Washington, D.C.: Government Printing Office, 1968), pp. 60-63, tables 5-1, 5-3, 5-5, and 5-7.



### *National Economic Consequences*

To what extent, then, does U.S.-controlled investment in subsidiaries in the less-developed countries contribute to import substitution? There can be no serious doubt that the import-substituting effect exists and no substantial hope that the effect can be closely quantified. All one can say is that, where such investment takes place, the effect is probably to accelerate the shift from exports to local production; that the acceleration is probably more pronounced for large countries than for small,[30] more pronounced for advanced industries than for simple ones.[31] A corollary of this conclusion is that newly established subsidiaries are more likely to generate import-substituting effects than subsidiaries of long standing, especially if the subsidiaries have not been assiduous in rolling over their products or processes. The truth about import substitution, therefore, probably varies from country to country, while lying well away from the extreme assumptions of either model.

For all the complexity of analytical structures such as the Treasury model, they do not even purport to deal with the effects that operate through the impact of such investments on productivity and prices. The characteristic trigger for foreign direct investment in manufacturing facilities in the less-developed economies is a decision of the country to shut off imports and raise the domestic price level of the products concerned. The resulting rise in price level need not always be large; in a few countries governments have tried to be judicious in the selection of industries for protection. Still, there is considerable evidence in many less-developed economies that the institution of import-substituting industrialization has helped to elevate the level of internal prices and cumulatively to overvalue the nation's currency.[32] The effect of this process is eventually to place a damper on exports, as internal prices rise and as the external value of the currency lags in its adjustment to those internal changes. To the extent that foreign-owned subsidiaries have contributed to the process of import substitution, part of

the resulting impact on the balance of payments is to be attributed to them.*

A second factor that can exert its force in the balance-of-payments calculations runs in just the opposite direction. The effect of the industrialization process to which the foreign-owned subsidiary has contributed is eventually to increase the productivity of the factors of the country, whether through scale and agglomeration effects, capital accumulation, or the upgrading of the labor force. This factor in time could express itself in a lower—not a higher—price level in the less-developed country than would otherwise have prevailed. A lower price level could mean a higher volume of exports; if this were the result, it could easily swamp other balance-of-payments effects. Indeed, as observed in Chapter 1, the shift in emphasis from import replacement to export development is already in full swing in some less-developed countries, and foreign-owned manufacturing subsidiaries are playing a leading role in the change. It is a commentary on the dynamic character of developments in this field that the study summarized in Table 5–2, based on the conditions of the early 1960s, barely acknowledges the possibility of manufactured goods exports by subsidiaries from the less-developed areas.†

The problems of estimating the balance-of-payments impact of U.S.-controlled enterprises in the less-developed areas, difficult enough in the manufacturing industries, have proven even more complex with respect to investments in raw materials. As has been emphasized repeatedly in earlier chapters, a considerable part of the output of raw materials in the less-developed countries finds its way into the marketing and fabricating facilities of U.S.-controlled multinational enterprises. As far as the host countries are concerned, it is hard to place a value on this downstream tie. Would the product be marketable if these facilities were withdrawn, and if so at what price? In products such as bauxite, the effort to estimate the recovery value of the product is thwarted by the absence of a free market of any significant size; in products such as oil and copper, by the imperfect nature of the market that exists. Because of the oligopolistic character of the market, the choice of raw material sources on the part of users is only partly a question of cost. Exports depend perhaps as much on the desire of the multinational enterprises that use the materials to balance the conflicting demands of different host countries and to maintain diversified sources of supply.

* In the pure case of model B, the price effect of the foreign investment might be counted as benign, because the alternative to the foreigner's investment is assumed to be an investment by local producers.

† The characteristic slowness to recognize the development is even more pointedly illustrated in Keith Griffin, *Underdevelopment in Spanish America* (London: Allen & Unwin, 1969), pp. 220–244, where the extreme difficulty of developing manufactured exports from Latin America to the advanced countries is eloquently argued.





In the case of raw materials produced in tightly integrated industries, the presumption is strong that U.S.-controlled investment contributes favorably to the balance-of-payments position of the host country. It would be hard to doubt, for instance, that the balance-of-payment position of such countries as Saudi Arabia, Libya, Nigeria, and Venezuela has been helped by the activities of U.S.-controlled enterprises, as compared with any plausible alternative.[33] But the kind of meticulous estimating approach implicit in models of the type described earlier is obviously even more vulnerable here. Clearly, the model A type of assumption—that local production would not take place in the absence of the U.S.-owned enterprise—is too simplistic to be very useful; so is the assumption of model B, that local production would inevitably take place whether or not the foreign-owned investment occurred. Both models imply a restructuring on radically different lines of the industries producing raw materials. Price patterns would change; tax effects would be shifted; efficiency levels would be altered; demand would be affected. In the case of raw

materials, even more than in that of manufactures, the failure to handle these issues explicitly would sharply limit the credibility of the model's predictions.

Still, even in raw material industries, one cannot always say that the effect of U.S. foreign direct investment is favorable in the long run to the payments position of less-developed areas. The sustained existence of large raw material industries in some countries tends to create an equilibrium rate of exchange that blights the possibility of competitive manufactured goods exports and handicaps local import substituting industries.[34] So even here, one is reduced to equivocal statements about the long-run balance-of-payments effects of foreign direct investment.

### THE STOCK OF PRODUCTIVE RESOURCES

Apart from balance-of-payments effects, another key question regarding the impact of U.S.-controlled multinational enterprises in the less-developed countries has to do with their effect on the countries' resources. That question breaks down into two parts: the effect on natural resources, and the effect on human resources.

Perhaps the most spectacular allegations that U.S. enterprises have been wasteful of natural resources relate to the role of the U.S. oil companies in Mexico during the period from the early 1920s until the time when their assets were nationalized in 1938.[35] During this period, so the allegation goes, the decline in Mexican oil production was owing in part to the wasteful cost-cutting practices of the foreign-owned enterprises. Even in this case, however, the record is uncertain. As usual, the question is whether any producer of oil, foreign or domestic, would have followed a policy of "creaming" the Mexican fields, given the decline in world demand at the time and the appearance of cheaper sources of oil elsewhere. One comes away from the question with the suspicion, but no more



than the suspicion, that the worry of less-developed governments is real, that is, that alternative arrangements extracting more net benefit from the existing pool of natural resources could be envisaged. But the question of articulating the assumed alternatives still remains. We are, in short, back to the usual question: "As compared with what?"

A judgment of the relative enrichment effects of foreign-owned enterprise on human resources, like a judgment with regard to natural resources, can only be based on a speculative leap. That speculation carries the discussion back to a model that has become familiar through repetition in the earlier chapters.

As long as foreign-owned enterprises are introducing products or processes that are new to less-developed areas and that would otherwise not have been introduced, there is a high probability that such enterprises add to the capabilities and productivity of local labor and capital.* The effects of U.S.-controlled automobile enterprises in Latin America on local component manufacturers, for example, are fairly well documented.[36] A more general tie between the degree of foreign private direct investment and the rate of productivity growth has been noted in the case of Argentina.[37] Of course, if the advantages provided by foreign-owned enterprises could just as well have been acquired by other arrangements, such as technical assistance contracts, then it would be hard to say that the foreign subsidiary was making any more substantial contribution to the enrichment of human skills in the country than the available alternatives. But the newer and more difficult the nature of the undertaking, the less likely it is that such alternatives will be available.

* This assertion, of course, begs such critical questions as whether radios or automobiles or urban agglomerations are a "good thing" for less-developed countries, as well as the related question whether the resources used in their making might have been used to better social purpose. Answers to these critical issues demand a frame of analysis of a different sort, dealt with briefly in a later chapter.

After a new product or process has been introduced, however, the usual decline in relative benefits probably sets in. The longer the enterprise operates on its original technological and organizational base, the less there is to be learned locally. What is more, the longer the enterprise operates, the more likely it is that alternative means will exist for acquiring the necessary technology and organizational skills. In due course, the local personnel associated with the subsidiaries of foreign-owned enterprises, including employees and suppliers, may be gaining very little in capability and productivity.

At some stage, therefore—generally well after the foreign-owned enterprise has been established in the less-developed country—the question may arise whether the existence of the foreign-owned enterprise tends to stifle the development of human skills in the country more than it contributes to those skills. The prevailing assumption in some of the less-developed countries is that the formidable position of the foreign-owned enterprise tends to kill off the disposition of local entrepreneurs to launch a competing business, even though they would be perfectly capable of operating the business efficiently.[38]

On the face of it, this line of speculation looks plausible. If the argument has a weak link, it is to be found in the assumption that foreign-owned enterprises in the less-developed country remain unchanged in character over any long period of time. In the more advanced industries, the assumption is especially weak. Stimulated by opportunity or pushed by local government pressure, enterprises in such industries have commonly responded by continually upgrading their technological and organizational contributions. On the other hand, in other lines of economic activity, especially in lines in which oligopoly rests on the establishment of distinctive brand names and on consumers' preferences for such names, the change seems to have been slower and the risk of stifling local entrepreneurship commensurately greater.





DEPENDENCE AND DISTORTION

Practically all countries that harbor the subsidiaries of multinational enterprises suffer from a sense of dependence, a sense that is nurtured by the assumption that these enterprises may have extensive geographical options and that the exercise of these options could easily affect the local economy. Though the point may hardly seem to need repeating, this sense is especially acute in the less-developed countries because of their relative size and their relative reliance on foreign-controlled raw material exporters. The history of raw material exploitation, as is well known, is filled with cases in which those options were exercised.[39]

The economic concerns of less-developed countries, however, involve not only the familiar issues of dependence but also a group of issues that commonly go under the heading of "distortions." For instance, because those enterprises have their origins in the advanced countries, the assumption is that they are most at home with a certain kind of technology—a technology based on large scale, on cheap capital, and on relatively expensive labor.[40] This kind of orientation is thought to produce various harmful effects on the economies of the less-developed countries.[41] One of these is the misuse of local resources—misuse in the sense that too much capital and too little labor are used, given the relative price and supply of those local factors.[42]

The actual facts are, as usual, obscure. There are no comprehensive data on the degree to which multinational enterprises adapt their production processes to the conditions of less-developed countries, and scarcely any data at all on the comparative adaptive actions of local competitors. The prolonged debate among economists over factor reversals in the application of production processes in different countries has left behind a litter of conflicting and half-documented views.[43] To the extent that data exist at the individual enterprise level,

they suggest that in some cases a considerable amount of adaptation actually does take place in multinational enterprises as they move their products and processes across international boundaries into less-developed areas.[44]

This is not to say that many foreign-owned enterprises approach the question of an appropriate technology with a totally clean slate. Few ask: If we were beginning from ground zero, how best would we produce in less-developed areas, given the differences in scale, factor costs, and reliability of supplies. Still, some adaptation occurs as enterprises respond to the obvious environmental differences. Following the easiest path, some enterprises have been known to fall back on the use of a product or process that they had outgrown in their more advanced markets. Adjustments of this sort generally move the enterprise toward processes that are appropriate to a smaller scale of output and to more labor-intensive methods. Of course, when multinational enterprises take this step, desirable though it may be, they court the risk of being charged with dumping second-hand machinery or obsolete products on the less-developed host economy.*

The propensity of different enterprises to adapt their technology may well be accidental in part, depending on the experience and knowledge of the production men involved. But there is some evidence that the propensity is not wholly idiosyncratic. According to one of the very few studies on the subject, the degree of adaptation depends partly on the strategy these enterprises are pursuing.[45] U.S.-controlled multinational enterprises that think of their market position as being based on product quality are loath to experiment with changes in their production processes, whereas enterprises that think of their market positions as being dependent mainly on cost and price considerations are more prepared to make such changes. The same study suggests that adaptation is less likely to occur if production costs are a small part of the total sale price (as in pharmaceuticals) than if production costs are a large part of price (as in sewing machines). When management is scarce and overburdened, as it commonly is, first things come first.

* The tendency of subsidiaries of U.S. enterprises in Mexico and Puerto Rico to use second-hand equipment was quite strong during the early 1960s; see W. P. Strassmann, *Technological Change and Economic Development* (Ithaca: Cornell University Press, 1968), p. 208. But the choice seemed sensitive to the nature of the manufacturing process, and the available data were not sufficient to control for that variable.

*National Economic Consequences*

When foreign-owned subsidiaries are unwilling to shift from capital-intensive to labor-intensive processes, that unwillingness is sometimes owing to a quite rational evaluation of the consequences of shifting, rather than to ignorance and indifference regarding the advantages of shift.[46] Sometimes, to be sure, a rationality that produces good results in private terms generates bad results by social yardsticks. When labor is unreliable and inefficient because of disease and malnutrition, it may be socially harmful to avoid its use.

At other times, however, the criteria for the private decision and the social decision are quite compatible. Cases can be found, for instance, in which engineers have deliberately designed plants and products for use in less-developed areas in such a way as to ensure that the products met acceptable quality standards abroad, or in such a way as to avoid having to rely on types of local labor that are particularly scarce, such as maintenance specialists, supervisors, and inspectors.[47] It may be, too, that production specialists are intuitively aware of what economists are just beginning to realize, namely, that when compared with the standards of more advanced countries, labor in underdeveloped areas tends to be more efficient in activities that are machine-paced than in those that are not.[48] Even when labor's efficiency has not been adversely affected by labor-intensive methods, rational decision-makers have had to consider whether such methods affect the length of the production cycle and hence the inventory costs of the process. In sum, though the assumption that labor-intensive methods are economic in labor-surplus societies may be a good starting

point for generalization, it requires all sorts of careful qualification; and the qualification is necessary whether the judgment is made on the basis of social criteria or private criteria.

The issue of factor uses and proportions has implications not only for efficiency and growth but also for welfare and equity. Stated in the form of a narrow economic question, the issue is posed in terms of income and distribution: How are the income rewards of development being shared?

In many countries, including India, Pakistan, Colombia, Mexico, Brazil, and Chile, the development of the economy has gone hand in hand with the growth of government employees and of a new class of wage earners, salaried employees, and managers associated with modern industry and commerce. If too much capital and too little labor are being used in these countries, then the class associated with modern activities reaps more of the rewards than it ought to. And if they are sharing in the foreign investor's monopoly rents by means of partnerships in the foreign-owned enterprises, then the inequities of income distribution are greater still. The linkage between those that have benefited from modern economic activities and the presence of foreign-owned subsidiaries has been made particularly explicit among intellectuals in Latin America.[49]

The issue is real; the question of measurement is something else again. Data on income distribution in the less-developed countries for any point in time leave something to be desired. Data that purport to measure trends over time are even more questionable.[50] The few studies that have some basis for statistical credibility readily confirm a fact that is all too painfully visible—the vast income disparities within the less-developed countries.[51] At the same time, they suggest the relatively rapid growth in the last decade or two of an upper-middle-income class in developing Latin American economies. The economic question that remains obscure is what would have happened to local income distribution in the absence of the foreign-owned subsidiaries. Only one thing can be said with reasonable



assurance regarding the operations of these subsidiaries: that they have a propensity for paying relatively high wages as compared with locally owned industry. But if this propensity goes with a tendency to employ less labor, the income distribution effects are uncertain.

The concern over economic distortions created by foreign-owned subsidiaries has taken many forms. Advertising that stimulates the demand for any product can be thought of as a distortion. It is said to distort if it creates a preference for foreign over local products that are similar in character, creating a basis by which the foreigner captures a monopoly rent. It is also regarded as distorting if it increases the aggregate demand for some products, especially for products that have an offensive connotation for the observer. The advertising of Coca-Cola or Ford, according to the views of some economists, generates distortion because it stimulates consumption without a welfare increase that they consider commensurate. Tales, real or otherwise, of triumphal campaigns for the sale of electric sewing machines among the unelectrified villages of the Peruvian *altiplano* confirm the worst suspicions of such economists.[52] But dependence and distortion are relative concepts. Dependence and distortion, as compared with what?

Irrespective of the internal role of foreign-owned enterprises in the less-developed countries, these countries are bound to rely heavily on the technology, the markets, and even the consumption norms of outside nations. The tie is particularly strong because so-called modernizing attitudes, such as the desire for more education, growth, and choice, as well as the willingness to save, are commonly found closely linked with a desire for "modern" goods.[53] If the economy is small, the reliance is likely to be great; if the economy is committed to rapid growth, the reliance may be greater still. Iran, now undisputed owner of her national oil reserves, is no less dependent on access to outside markets than she was in the days of Mossadegh, two decades earlier. Egypt, having purged itself of much of its foreign invest-

ment, still depends critcially on outside markets to find its needed foreign exchange. The issue of dependence, therefore, may be associated less with the question of foreign ownership than with the issue of income, status, and power distribution inside the less-developed countries. This is why economists who profess to see major adverse effects from multinational enterprises in the less-developed countries so commonly prescribe not only the curbing of those enterprises but also major structural changes inside the less-developed economies. As many of them see it, the curbing of the multinational enterprise is a necessary but not a sufficient condition to their economic and social objectives.

## *The United States and the Global Economy*

Agnosticism in small doses may be tolerable; in larger quantities it becomes more difficult to abide. Yet an agnostic approach is called for once again when gauging the effect on the U.S. economy of the overseas activities of U.S.-controlled enterprises. If overseas investments by U.S.-controlled enterprises involved nothing more than a transfer of capital, there might be a case for dismissing the whole issue as trivial. In terms of resources lost to the U.S. economy through capital transfer, the effects seem minuscule. The capital that is represented in the official U.S. data as being transferred each year out of the United States is about $4 billion. If this figure were deflated in terms of U.S. opportunity cost—if capitalized knowledge were taken at zero and second-hand machinery at the going price—it would perhaps be $3 billion. This is less than 2 percent of annual gross capital formation in the United States.

When balance-of-payments effects are the yardstick, the case is changed from one of triviality to one of uncertainty. The results of the U.S. Treasury studies are consistent with almost any kind of conclusion about the balance-of-payments impact, except perhaps the conclusion that the impact is obvious and strong.[58]





When measurement effects of this sort are tested against the description of the investment process contained in earlier chapters, however, their shortcomings are striking. The decision of U.S. parents to place subsidiaries in other countries is part of a dynamic process whose effects are complex and elusive. Because the industries involved are characteristically structured on oligopolistic lines, the assumption that each firm's existence is a simple function of the capital and labor that make it up is inadequate. The decision of Kennecott or Cerro de Pasco not to search out new ore reserves in South America but to extend their existing developments on the North American continent would be a distinctive event whose effects, good or bad, could be profound. One could measure the capital and labor made idle by the decision, but the measurement would be a barren exercise. The reason, of course, is that a decision not to invest would set in train a series of consequences, benign or adverse, whose repercussions would be captured or borne by others outside the enterprise. The effect of these external economies or diseconomies may not be very large in any single year; but cumulatively, measured over a number of years, it is hard to dismiss the view that they can profoundly affect the national economy.

For the layman, there is nothing very threatening in these statements; having begun his inquiry with no particular commitment to any disciplined point of view, he has no difficulty in entertaining any proposition that seems reasonable on its face. For the economist, some of these propositions are disconcerting. What they suggest is that the impact of international investment is not necessarily measured by such figures as yield on investment, payments to labor, and tax payments. The effects recorded by these measures could be swamped by those outside the recording net, especially if the effects run over a number of years.

Department of Economic and Social Affairs

# MULTINATIONAL CORPORATIONS IN WORLD DEVELOPMENT

UNITED NATIONS

New York, 1973

## Sovereignty

In a certain sense, the manifold operations of foreign-based multinational corporations and their pervasive influence on the host country may be regarded as a challenge to national sovereignty. The challenge has, moreover, economic, social, political and cultural dimensions which are frequently inseparable from one another. The tensions and conflicts thus generated are, likewise, the result of complex interaction between many agents in many areas.

Frequently, the multinational corporation is perceived as capable of circumventing or subverting national objectives and policies. 6/ While foreign affiliates can and often do choose to integrate their activities with national plans, the mere possibility of their being able to choose - and to afford to do so - is unsettling for host countries, developed as well as developing. 7/

Generally, the powerful multinational corporations possess a variety of options in response to governmental policies. This is particularly so in the case of manufacturing affiliates for which locational advantages are not rigidly determined. In contrast, affiliates involved in the field of natural resources have more limited locational options, since they are tied to the sources of raw materials, and hence are more susceptible to governmental incentives or pressures.

On the other hand, it is the operation of the multinational corporations in the field of raw materials which gives most immediacy to the issue of sovereignty, especially in developing countries. The presence of multinational corporations in the extractive industries is highly visible; they own land in the host country and they make decisions involving the extraction of usually non-renewable natural resources.

The principle of permanent sovereignty over natural resources, generally accepted by the international community, 8/ is raised when disputes arise over the control and distribution of benefits. Similarly, foreign plantations and land operations pose particularly sensitive issues of foreign intrusion. When nationalization is resorted to, the question of adequate compensation frequently arises. In some cases, attempts by multinational corporations to seek better compensation through legal action and sanctions by governments and financial institutions tend to escalate the conflict.

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6/ See, J.N. Behrman, National Interests and Multinational Enterprise, op. cit.

7/ According to the Report of the Task Force on the Structure of Canadian Industry, op. cit., "The tendency inherent in direct investment to shift decision-making power in the private sector outside Canada, has on occasion posed serious problems for those responsible for formulating Canadian policy, and has created widespread unease among Canadians as to the continuing viability of Canada as an independent nation-state."

8/ See General Assembly resolutions 525 (VI) of 12 January 1952, 626 (VII) of 21 December 1952, 1314 (XIII) of 12 December 1958, 1515 (XV) of 15 December 1960; 1803 (XVII) of 14 December 1962, 2158 (XXI) of 25 November 1966 and 2692 (XXV) of 11 December 1970; and General Principle Three, adopted at the first session of the United Nations Conference on Trade and Development (UNCTAD).

National objectives and planning

The issue of sovereignty is related to the ability of the host country to shape its own objectives. These objectives may be explicitly formulated in a national plan. Differences in both scope and content between national and corporate planning are sources of conflict. 9/ It is not certain whether affiliates of foreign multinational corporations will sacrifice essential needs of the corporate global strategy in order to fulfil the requirements of the national plan. For instance, where the focus of the national plan is on rural development, or on the traditional sector, multinational corporation operations may concentrate on urban areas or on the modern sector. Where the national plan aims at more equal distribution of income, the effect of multinational corporations may be to accentuate inequality. Where the creation of employment is a major goal, the techniques and products introduced by the multinational corporations may be largely labour-saving. Moreover, the creation of wants similar to those of the developed societies through advertising may create a pattern of consumption that is unfavourable to development.

At the same time, the difficulty of reconciling national and corporate objectives may be partly due to deficiencies in the national plan. In many cases, plans fail to provide adequate guidance for the activities of the private sector, whether domestic or multinational corporations. When plan objectives are clearly stated and concrete measures are put into effect, multinational corporations may in fact be responsive to them. 10/

Pattern and process of development

Often it is not the divergency in explicit objectives but the subtle impact of the multinational corporation on the process and pattern of development that is the source of tensions and conflicts.

To begin with, the operations of multinational corporations may be destructive of the local economy. For instance, the introduction of machine-made goods may contribute to net output but only at the expense of displacing handicraft products. Although this is a common phenomenon in the process of modernization, caused also by domestic enterprises, the ousting of local products by the output of multinational corporations and the displacement of indigenous entrepreneurs by foreigners are highly visible and much resented.

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9/ In contrast to the national private sector, managers of foreign corporations do not usually participate in the preparation of the plan, either because they are not thought to share national aspirations or because they are not given the authority by the parent company to commit it on essential issues.

10/ According to Behrman, there is evidence that multinational corporations have in many cases responded favourably by locating in depressed areas, e.g. Firestone, Goodyear and Courtaulds settled in depressed areas of France. See, J.N. Behrman, United States International Business and Governments (New York, 1971), p. 36.

On the other hand, when a multinational corporation operates in a more or less self-contained fashion, without any significant change in the old order, as though an oasis had been created in a desert, the question arises as to whether much benefit can be derived from the "enclave". Indeed, the enclave-type of activity may be considered a typical case of "growth without development", in the sense that fundamental economic structural transformation fails to take place on a broad basis.

In practice, even a foreign enclave has some links with the local economy. The linkages of multinational corporations with the host country economies, however, may sometimes be tenuous or limited. Recent studies suggest that almost half the inputs of foreign firms are supplied locally. The ratio is lower for export products than for those oriented toward the local market. Although the local share is not insignificant in most cases, it may fall below the host country's expectations.

From the point of view of the process of development, it is not only the amount of local inputs but also the type that is important. This depends on the activities of the foreign affiliates themselves. It is often observed that foreign affiliates tend to be "truncated". In other words, they do not "carry out all the functions - from the original research required through to all the aspects of marketing - necessary for developing, producing and marketing their goods. One or more of these functions are carried out by the foreign parent". 11/ Thus, research and development, and components and services, especially the more sophisticated, may be procured from the parent company or elsewhere. While such practices may be rational from the point of view of the global strategy of the multinational corporation, they are seen by some as an instrument for increasing the dependence of the periphery on the centre. More generally, the structure of industries in the host country may be so lopsided as to hinder sustained development. 12/ This is most glaring in cases where activity is highly concentrated in those sectors, such as luxury articles catering for the few, which have limited prospects of interaction with the rest of the economy. 13/ Indeed, not enough has been done either by the multinational corporations themselves or by governments to channel corporate production towards satisfying basic consumption needs in nutrition, health and housing.

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11/ Government of Canada, Foreign Direct Investment in Canada (Ottawa, 1972), p. 405.

12/ H.G. Johnson, "The multinational corporation as an agency of economic development: some exploratory observations" in B. Ward, L. d'Anjou and J.D. Runnals, eds. The Widening Gap: Development in the 1970s (New York, 1971).

13/ S.H. Hymer, "The efficiency (contradictions) of multinational corporations", American Economic Review, LX No. 2, May 1970.

Technology and skills[14]

It has long been recognized that private direct investment through the multinational corporation is unique in providing from a single source a package of critical industrial inputs: capital, technology, managerial skills and other services required for production and distribution.

The scale requirements of present research and development activity, the decrease of technological and commercial risks in the development of new products and processes through multi-product and/or multinational operations, as well as the specific organizational requirements for the application of science and technology to economic needs, give a particular comparative advantage to the multinational corporation. Quite often this advantage has rested on its ability to combine for commercial use different developments in science and technology for which the basic research was undertaken elsewhere.

Indeed, multinational corporations generally do not undertake major innovative research without visible prospects of a substantial market, unless they are subsidized. Thus, although a large part of commercialized technology is in the hands of multinational corporations, the basic knowledge often originates in government-financed research and training centres. 15/ The contributions of multinational corporations derive from their ability to combine different kinds of lasting knowledge into commercially viable processes and products. In other words, the expenditure on technology financed by the corporation is in most cases related to practical development rather than to basic research. 16/

The part of research and development expenditures undertaken by the business enterprise sector appears to be concentrated in a few firms. For example, in 1964 in the United States, of more than 2,000 firms which reported research and development activities, 28 accounted for about 63 per cent of the total. Similarly, in France, 16 out of 440 enterprises accounted for 43 per cent of total research and development expenditure. 17/

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14/ See tables 38 to 40 in annex III.

15/ According to the Organisation for Economic Co-operation and Development, a significant part of the research and development performed in the business enterprise sector was quite often financed by governments. For example, during 1963-64, of the total business enterprise research and development undertaken in the United States, 51.2 per cent was financed by defence, space and nuclear agencies. The equivalent percentages for other countries were as follows: United Kingdom 32 per cent (1964-65); Sweden 25.8 per cent (1964); France 24.9 per cent (1964); Federal Republic of Germany 13.5 per cent (1964); Austria 10.7 per cent (1963). See Organisation for Economic Co-operation and Development, Gaps in Technology, Analytical Report (Paris, 1970).

16/ In 1965 in the United States, out of total company-funded activities only 6.5 per cent went to basic research. See Organisation for Economic Co-operation and Development, op. cit., pp. 130 and 165.

17/ See Organisation for Economic Co-operation and Development, Gaps in Technology: General Report (Paris, 1968), p. 15.

Furthermore, the bulk of the research and development financed by corporations is done by the parent corporation or in the home country of the parent. For instance, in 1966 only 6 per cent of the total research and development budget of United States multinational corporations engaged in manufacturing was spent abroad.

As far as developed economies, which serve as both home and host countries, are concerned, technology flows and payments for them move in both directions between buyers and sellers, with different net effects depending on their relative magnitude. For developing countries on the other hand, the flow is predominantly or exclusively in one direction.

The significance of this one-sided flow is illustrated by data on six developing countries in the late 1960s. 18/ Payments by these countries for patents, licences, know-how and trademarks, as well as management and service fees, amounted to approximately 7 per cent of their combined exports and to a little more than half of 1 per cent of their combined gross domestic product. The total cost for such payments for 13 developing countries, representing 65 per cent of the total population and 56 per cent of the total gross domestic product of developing countries, is estimated at approximately $1.5 billion, which amounts to more than half of the flow of direct private foreign investment to developing countries. These payments are growing steadily at a rate which is estimated by the UNCTAD Secretariat at about 20 per cent per annum on the average and are absorbing an increasing proportion of the export earnings of developing countries. 19/

Estimates of royalties, however, may distort the true payments for know-how in various ways. The distortion may take the form of overpricing of intermediate products and capital goods, which are tied to the imports of technology, or the underpricing of exports to the suppliers of the technical know-how. Since royalties constitute only one of the channels of effective income remission, especially in the case of wholly-owned subsidiaries, changes in royalty payments do not necessarily imply changes in technology flows. They may simply reflect a readjustment in the distribution of returns among the different channels of income remission as a result of corporate strategy and government policies.

The effect of technological advances on the international market, given the existing concentration of products and know-how in the hands of the multinational corporations, has become one of the main causes of monopoly or oligopoly control. This is reinforced by the existence of specific legislative provisions, such as the patent laws, which give exclusive power over the use or licensing of certain innovations. The dedication of significant amounts of resources by the multinational corporations and their corporate commitment to technology is largely induced by the expectation of monopoly

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18/ Argentina, Brazil, Colombia, Mexico, Nigeria and Sri Lanka.

19/ See United Nations Conference on Trade and Development, Transfer of Technology, TD/106, 10 November 1971.

rents from new products and processes, as well as from the need to match the efforts of other such firms in order to protect their market participation and share. Since the technology supplied by the multinational corporations is proprietary and part of it is patented, an issue arises about the justification and impact of the system of patents and trade-marks. 20/

It should be noted that an important part of the technology required for most industries in developing countries is not subject to patents; the critical limitation these countries face is access to proprietary know-how. There is now a significant tendency to modify and strengthen the apparatus of national and international patent institutions into vehicles for the storage, retrieval and dissemination of industrial information and for facilitating direct contacts with licensors and other sources.

Multinational corporations are only one source from which enterprises in developing countries may acquire proprietary technology and management. For some technologies the options may be limited, but the situation is continually changing. Most developing countries are increasingly taking steps to reappraise the changing supply conditions for technology with a view to obtaining technology which will yield a larger measure of social benefits, as well as replacing imported proprietary technology and other factors with local inputs.

The policy objectives of host countries in this area have been multiple. The aim has frequently been to capture a larger share of a given net benefit in the use of technology from the local affiliates of foreign firms and/or to increase the total size of the benefit to be divided by promoting greater domestic value-added and various socially desirable "externalities", such as local skill formation. Another strategy has been to explore the possibility of disaggregating the package of foreign inputs, particularly by obtaining technology and management through commercial channels separately from capital. Among the alternatives are foreign minority joint ventures, licensing of proprietary information and management contracts, sometimes in various combinations or, in the case of so-called direct or "embodied" imports of know-how, by contracting for the construction and running-in of "turnkey" plants and by the direct purchase of specialized industrial equipment. 21/

Apart from reflecting negative attitudes towards control by the multinational firm and other motivations, the search for alternative vehicles for the acquisition of proprietary technology implies a recognition, particularly

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20/ The positions taken range from the extreme view of denying the economic justification of the patent system on the grounds of a theoretical "first best" welfare alternative of state ownership and distribution of all such industrial technology, to the advocacy of some tightening of regulations over the award to and use by licensors of such legal rights.

21/ "Turnkey" arrangements refer to contracts with foreign enterprises whereby the role of the latter is limited to establishing and bringing the plant into a position to begin operations.

by governments of developing countries; that the market conditions under which such technology is available, whatever the transfer mechanism, are those of an imperfect-competitive market reflecting, on the one hand, a degree of market control or oligopoly by the suppliers and, on the other, various limitations on the bargaining power of enterprises in the host country and of the government of the home country itself. 22/

Another and increasing concern of the developing countries is whether the technology obtainable through the multinational corporation and other commercial channels is appropriate to their conditions. This is only part of the larger issue of the development and choice of appropriate technology - particularly in relation to the problem posed by superabundant labour and scarce capital and by the limited size of domestic markets - but the prominence of the multinational firm as a delivery vehicle for such technology and as a major agent of centralized research and development activity naturally focuses attention in respect of this problem on the performance of multinational corporations.

Employment and labour 23/

On the whole, the net employment impact on the host countries is positive since extreme cases of destruction of local industries and wholesale displacement of labour are rare. At the same time, the direct employment contribution by foreign affiliates is modest in a global perspective. 24/ This is indicated by data from the United States which is the largest contributor. In 1970, the total number of employees of United States majority-owned foreign affiliates amounted to about 3 million. When direct employment by foreign affiliates of other countries as well as other United States-controlled affiliates is added, it is probably no more than 13 or 14 million; this is a small fraction of total employment in market economies.

The indirect employment effects, largely arising out of the use of local suppliers, distribution channels and ancillary services, are, of course, much larger, but the total employment impact, while significant for the modern sector, is still modest in the context of the total economy.

For the developing countries as a whole, the employment contribution of foreign affiliates is small in relation to the massive employment problem.

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22/ See Walter A. Chudson, The International Transfer of Commercial Technology to Developing Countries, United Nations Institute for Training and Research (UNITAR), Research Report No. 13 (New York, 1971) and a series of related UNITAR Research Reports; also UNCTAD, Guidelines for the Study of the Transfer of Technology to Developing Countries, December 1972. (United Nations publication, Sales No. E.72.II.D.19).

23/ See, International Labour Organisation, Multinational Enterprises and Social Policy, Studies and Reports, New Series, No. 79, (Geneva: ILO, 1973).

24/ Grant Reuber, "Private foreign investment in less developed countries", paper presented at International Meeting of Directors of Development Research and Training Institutes, Belgrade, 28-30 August, 1972.

This appears to be especially the case in respect of foreign affiliates' participation in the extractive industries which, when operated on a large scale, are highly capital intensive. In Venezuela and Chile, for example, despite the importance of oil and copper, labour employed in the combined petroleum and mining sectors accounted for 2.3 per cent and 4.1 per cent, respectively, of the total economically active population in 1960. Moreover, there appears to be very little growth in employment in the foreign-operated large-scale extractive industries. 25/

On the other hand, the effect of foreign affiliates on employment in specific localities is often a major attraction in a given multinational corporation project. This is especially true of depressed areas, where the location of a plant can make a significant contribution to solving the local unemployment problem. There is thus a tendency towards keen competition for the foreign enterprise among the various localities.

Moreover, the contribution through "learning by doing", especially for technical and professional employees, may be significant. 26/ Thus, an OECD study shows that for a sample of 50 foreign investment projects, local clerks and accountants accounted for 97 per cent of the staff concerned, foremen and supervisors 90 per cent, sales and marketing personnel 80 per cent, management and engineering personnel 73 per cent. There is, moreover, a tendency of the local share to increase over time, especially in the professional categories. Furthermore, many managers and technicians move from foreign affiliates to domestic enterprises. Nevertheless, the particular skills learned may be more suitable to the activities of foreign enterprises than for national development. Similarly, they may be associated with technologies that are inappropriate for local conditions. 27/

The relatively high labour standards generally adopted by foreign affiliates of multinational corporations are a mixed blessing. In some host countries, the wage rates paid by multinational corporations are several times higher than those prevailing elsewhere. The creation of an élite labour group raises irritating questions of competition, especially for technical personnel, with local enterprises. It also accentuates distortions in the wage structure, between occupational and skill groups as well as between rural and urban areas. Moreover, the standards imported from highly developed economies gradually tend to be adopted as a national norm, although they may be beyond the means of less-developed host countries, especially from the point of view of international competitiveness and employment.

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25/ Constantine V. Vaitsos, Employment and Foreign Direct Investments in Developing Countries: Some Notes and Figures, Junta del Acuerdo de Cartagena, mimeographed document J/AJ/35/Rev. 1 (Lima, 1973).

26/ Council for Latin America, The Effects of United States and Other Foreign Investment in Latin America (New York, 1970), p. 5.

27/ Grant Reuber, op. cit.

Another source of tension is the impact on local labour when local plants are shut down in line with a global strategy. Although there is little evidence that this happens frequently, when it does occur the adverse effects are highly visible and attract public attention and reaction.

Balance of payments[28/]

Evaluating the impact of multinational corporations on the balance of payments of host developing countries is no less complex a task than evaluating the impact on other economic variables. If the evaluation concentrates on the capital flow of direct investment, the effect on the host country is undoubtedly positive. For the developing countries as a whole, direct investment amounted to $4 billion in 1971, almost half the total official bilateral and multilateral flows. At the same time, if the earnings generated by past investment which accrue to the foreign affiliates are deducted from that flow, the net flow is generally negative for host countries. Between 1965 and 1970, net foreign direct investment inflow into 43 developing countries was 30 per cent of the investment income outflow. If the oil-producing countries in the sample are excluded, inflow was 68 per cent of outflow. [29/] The difference reflects the differing time patterns of capital flow and earnings rather than the balance of payments effect of a given investment. Nevertheless, in developing countries, where the supply of foreign exchange is often a problem, the excess of this outflow over inflow has been a familiar source of tension with multinational corporations. Such tension is particularly likely to occur in cases where a multinational corporation has operated in the host country for an extended period of time and where the outflow of investment income increasingly exceeds the inflow of new capital.

In addition to the effect on the capital account and the investment income account, a foreign affiliate also generates imports and exports. If it is assumed that these imports and exports would not otherwise be made, the trade effect on the host countries is generally positive. In Latin America, for example, in 1966, United States affiliates exported about $4.5 billion of their products and imported about $1.3 billion of materials and supplies.

When all the direct effects on the balance of payments accounts are taken into consideration, the net result in developing countries is usually positive, though it is more visible in the case of extractive industries than in the case of manufacturing, because manufacturing affiliates are heavily oriented towards

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28/ See also tables 41 to 43 in annex III.

29/ Another calculation of the flows, adjusted for petroleum, shows that between 1964 and 1968 the United States and the United Kingdom (representing 80 per cent of total foreign direct investment) received approximately $5.8 billion from developing countries (in investment income) and paid $3.2 billion (in capital flow). See, W.A.P. Manser, The Financial Role of Multinational Enterprise, (Paris, International Chamber of Commerce, 1973), pp. 17-30.

production for import substitution rather than for export, a fact which usually reflects the host government's industrialization policy. 30/ At the same time, the payments effect may be partly limited by export-restricting practices followed by the multinational corporation, and moreover, the import bill may be inflated by tied-purchases and over-pricing. 31/

The direct balance of payments effects of foreign affiliates do not, of course, answer the question of what the total effect may be. Thus, to the direct effects must be added the indirect effects resulting from the fact that the incomes and sales promotion generated by affiliates raise the level of income and thus induce higher consumption of imports and possibly even lower the export supply of some domestically produced goods. 32/ At the same time, insofar as the affiliate may serve as a "growth pole" stimulating the establishment of complementary domestic industries, it may also generate additional exports from the local production of other firms. Basic to the entire calculation of total trade effects is the question, at present unanswerable, whether the foreign affiliates' output is entirely additional to what would otherwise be produced or whether local replacement of output can be assumed.

When all the indirect effects are taken into account, the estimated net result varies with the assumptions made. For instance, a study of th impact of import-substituting United States manufacturing investment in developing countries reached different conclusions depending on the model used. 33/ The one based on the assumption that no local replacement was possible indicated a positive impact on the balance of payments of developing countries; the other, assuming local replacement, indicated negative impact in the case of Latin America, and neutral in other developing areas.

Other case studies made under the auspices of UNCTAD examined the over-all effect of several foreign manufacturing affiliates in Colombia, India, Iran, Jamaica, Kenya and Malaysia. 34/ It was found that in 55 per cent of a sample of 159 foreign firms, the impact was positive. In the case of the other firms, it was concluded that it would be cheaper for the host country to substitute its own capital for the existing foreign capital. However, 60 per cent of the firms

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30/ Among 159 foreign firms in Colombia, India, Iran, Jamaica, Kenya and Malaysia, 53 per cent had negligible exports or no exports at all. See, P.P. Streeten and S. Lall, UNCTAD, Main Findings of a Study of Private Foreign Investment in Selected Developing Countries, (TD/B/C.3/111), 1973.

31/ See UNCTAD, Private foreign investment in its relationship to development (TD/134), 1972.

32/ See detailed discussion in David Robertson, "The multinational enterprise: trade flows and trade policy" in John H. Dunning, ed., The Multinational Enterprise, (London, 1971).

33/ See G.C. Hufbauer and F.M. Adler, Overseas Manufacturing Investment and the Balance of Payments, (Washington, D.C., United States Department of Commerce, 1968).

34/ See, UNCTAD, TD/B/C.3/111, op. cit.

fall around the demarcation line between positive and negative impact, and only 21 per cent show a clearly positive, and 11 per cent a clearly negative, impact. On the whole, the study indicates that no conclusive results can be obtained. Uncertainty is high, as conditions change and effects differ greatly from case to case.

In host developed market economies, the impact of foreign direct investment on the balance of payments appears on the whole to be positive. In so far as evidence is available, the export performance of foreign affiliates seems to be as good as that of domestic firms and often better. It is better in the United Kingdom, for instance, where United States affiliates in manufacturing export on the average a quarter of their output - a much higher proportion than that of the average United Kingdom firm. 35/ It is equal to that of domestic firms in Canada and is increasing steadily. 36/ But it was also found, in Canada, that in a large number of cases foreign affiliates followed export-restrictive policies. This is apparently a reflection of the marketing strategy of parent companies, which try to protect export markets for themselves or for their other affiliates. They may also be obliged to resort to this practice either as a result of international market sharing with other multinational corporations, or in response to the governmental policies of the home country.

A large share of exports is, moreover, represented by intra-company sales. In the United Kingdom, half the exports of United States affiliates were made to affiliated firms. In Canada, as much as three-fourths of all exports of foreign affiliates were accounted for by intra-company sales in 1969. 37/ Such sales suggest a large scope for transfer pricing and the vulnerability of the host country's economy to foreign governmental or corporate policies.

As far as the import content of purchases by the affiliates is concerned, it appears to be relatively small in the case of United States affiliates in the United Kingdom and more important in Canada. Thus, three-quarters of the imports of foreign affiliates in Canada (which amount to one-third of their total purchases) originate with other affiliates and almost all the imports of United States affiliates originate in the home country. 38/

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35/ J.H. Dunning, United States Investment in Britain (London, 1972).

36/ A.E. Safarian, Foreign ownership of Canadian Industry (Toronto 1966). The share of exports of foreign affiliates to their total sales increased from 18 per cent in 1964 to 28 per cent in 1969. See Foreign Direct Investment in Canada (Grey Report), op. cit.

37/ The increase in this share from 52 per cent in 1964 largely reflects the very rapid increase in exports of motor vehicles under the Canada-United States Automotive Agreement. In 1969, more than four-fifths of the exports of foreign affiliates were made to the United States, while only half of total Canadian exports were sold to the United States.

38/ For the effect of short-term capital flows, see section on implications for the international monetary system below.

Socio-cultural considerations

The passage above has concentrated on the more tangible considerations. Even here, however, it is important to interpret these considerations in a broad sense. Thus, the issue of sovereignty is not simply jurisdictional but is intimately related to the rise of nationalistic feelings which may acquire special meaning as a rallying political force for cementing diverse interests and groups, especially in developing countries. The issue of development is not merely a matter of maximizing the growth rate of output but is inseparable from social needs and style of living. Even with questions of employment and balance of payments, it is sometimes the less tangible aspects that are more important.

The strong reaction against the multinational corporation in some host countries must therefore be understood in the broad socio-cultural context. The mere presence of powerful foreign enterprises may serve as a reminder of past foreign domination. The popular sentiment expressed in the form of consumer boycotts against the home country of certain multinational corporations testifies to the broad base of such sentiment and the readiness to make economic sacrifices.

In many host countries, there is growing dissatisfaction over playing a peripheral role, quite apart from the economic consequences. 39/ Host developing countries are, moreover, suspicious of the multinational corporations' style of doing things. Their financial power and easy access to the top hierarchy of government and business may be used, openly or covertly, to influence the domestic political process to their liking. Such alien influence is especially resented by local élite groups, such as intellectuals, government cadres, labour and business leaders, who see themselves as contenders for power and guardians of the values and heritage of the country. The multinational corporations, through their tacit alliance with certain social groups, may even be regarded as obstacles to appropriate social and political development.

The ostentatious living styles of foreign personnel as compared with those of domestic employees are a source both of envy and resentment. Styles of

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39/ See Raul Prebisch, Towards a New Trade Policy for Development, (United Nations, 1964); also, according to M. Wionczek in R. Vernon, ed., Latin America Views the Foreign Investor (New York, 1965): "The efforts of foreign capital to perpetuate the political and economic dependence of Latin America on the industrial countries, particularly dependence on the United States, represent probably the single most important element in the growing conflict between foreign private capital and Latin American society", p. 13. See also Edith Penrose, "The State and Multinational Enterprise in Less-Developed Countries" in J. Dunning, ed., The Multinational Enterprise, op. cit., and Andreas G. Papandreou, Paternalistic Capitalism, (Minneapolis, 1972). Even in host developed countries, similar views have been voiced; see, for instance, the 1969-1970 Report and Accounts of the Industrial Reorganization Corporation, (London, 1970). "Britain has also to protect her vital industrial interests as a state...if this was neglected Britain could find itself becoming a branch office economy where industries vital for growth, technology or defence were either absent or entirely directed from other parts of the world." p. 17.

management directed towards efficiency but insensitive to local cultural values may appear to people in the host country as arrogant and dehumanizing. Even the local people who receive a good technical training through working with the multinational corporations may be regarded as unduly influenced by alien values. Although these reactions may change with the change in attitudes on both sides, the intensity of the feelings that have been aroused should not be under-estimated.

The multinational corporation and the home country

Tensions between multinational corporations and their home countries have generally been kept down. Many home countries which are also hosts tend to view their own multinational corporations as a countervailing force to those of other industrial countries. European countries, for instance, often view theirs as an answer to the "American challenge", while Japan has endeavoured to make the activities of its multinational corporations consistent with its national objectives.

The chief home country to raise serious questions about the impact of its multinational corporations is the United States, whose experience as a host country is as yet very limited.

These questions range from domestic economic effects to balance of payments and foreign policies. Multinational corporations have been blamed for "exporting jobs" through "run-away plants" and for making high technology available to foreign lands or taking advantage of low-wage foreign labour. Moreover, the option open to the multinational corporation to locate plants in foreign countries tends to weaken the bargaining power of domestic labour.

As in the case of the consideration of the effect of multinational corporation on employment, trade and the balance of payments in host countries, there is considerable uncertainty about the effects on home countries, the conclusions depending upon the assumptions made regarding what the alternative to the multinational corporation's activities would be likely to be. 40/ A recent study on the effect of investment abroad on domestic employment in the United States between 1966 and 1970 shows that, under certain assumptions, the presence of United States plants abroad may have resulted in a net loss of 400,000 to 1.3 million jobs. Under an alternative assumption, the net effect may instead

40/ United States Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labor (Washington, D.C., 1973).

Table 40. Selected developing countries: payments of royalties and fees and their relationship to gross domestic product and to export earnings

(Millions of dollars and percentage)

| Country | Year | Payments of royalties and fees a/ (millions of dollars) | Share of payments | |
|---|---|---|---|---|
| | | | Gross domestic product (percentage) | Exports (percentage) |
| Argentina..... | 1969 | 127.7 | 0.72 | 7.9 |
| Brazil..... | 1966-1968 b/ | 59.6 | 0.26 | 3.4 |
| Colombia..... | 1966 | 26.7 | 0.50 | 5.3 |
| Mexico..... | 1968 | 200.0 | 0.76 | 15.9 |
| Nigeria..... | 1965 | 33.8 | 0.78 | 4.2 |
| Sri Lanka..... | 1970 | 9.3 | 0.51 c/ | 2.9 c/ |
| TOTAL, above and non-weighted average | | 457.1 | 0.68 | 7.3 |

Source: Centre for Development Planning, Projections and Policies of the Department of Economic and Social Affairs of the United Nations Secretariat, based on United Nations Conference on Trade and Development, Transfer of Technology (TD/106), November 1971.

a/ Includes payments by the private sector only for patents, licenses, know-how, trademarks and management and other technical services.

b/ Annual average.

c/ 1969.

Table 41. United States manufacturing and mining affiliates in Central and South America: local sales and exports, 1965, 1968

(Millions of dollars and percentage)

| | Manufacturing affiliates | | Mining affiliates | |
|---|---|---|---|---|
| | 1965 | 1968 | 1965 | 1968 |
| Total sales (millions of dollars)... | 5,526 | 7,966 | 1,345 | 1,814 |
| Total exports (millions of dollars). | 415 | 753 | 1,105 | 1,497 |
| Ratio of exports to sales (percentage)..... | 7.5 | 9.4 | 82.2 | 82.5 |
| Ratio of exports to United States to total exports of affiliates (percentage)..... | 24.3 | 28.1 | 48.4 | 46.4 |

Source: Centre for Development Planning, Projections and Policies of the Department of Economic and Social Affairs of the United Nations Secretariat, based on United States, Department of Commerce, Survey of Current Business, October 1970.

Table 42. Selected developing countries: current inflow of foreign direct investment and outflow of income on accumulated past direct investment, a/ by region, 1965-1970

(Millions of dollars)

| Region | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 |
|---|---|---|---|---|---|---|
| Africa, total | | | | | | |
| A. Inflow | 182.2 b/ | 163.7 | 241.5 | 201.6 | 235.5 | 270.7 |
| B. Outflow | 380.8 b/ | 718.8 | 708.6 | 963.7 | 924.3 | 996.2 |
| C. Balance | -198.6 | -555.1 | -467.1 | -762.1 | -688.8 | -725.5 |
| Non-oil producing countries c/ | | | | | | |
| A. Inflow | 133.5 | 74.7 | 61.5 | 53.6 | 46.5 | 42.7 |
| B. Outflow | 49.3 | 53.8 | 56.6 | 57.7 | 56.3 | 60.2 |
| C. Balance | 84.2 | 20.9 | 4.9 | -4.1 | -9.8 | -17.5 |
| Oil-producing countries d/ | | | | | | |
| A. Inflow | 48.7 b/ | 89.0 | 180.0 | 148.0 | 189.0 | 228.0 |
| B. Outflow | 331.5 b/ | 665.0 | 652.0 | 906.0 | 868.0 | 936.0 |
| C. Balance | -282.8 | -576.0 | -472.0 | -758.0 | -679.0 | -708.0 |
| Western hemisphere, total | | | | | | |
| A. Inflow | 723.3 | 780.5 | 647.5 | 1,011.4 | 1,088.6 | 1,141.9 |
| B. Outflow | 1,437.9 | 1,752.7 | 1,793.4 | 2,021.4 | 2,093.0 | 1,943.7 |
| C. Balance | -714.6 | -972.2 | -1,145.9 | -1,010.0 | -1,004.4 | -801.8 |
| Non-oil producing countries e/ | | | | | | |
| A. Inflow | 642.3 | 671.5 | 567.5 | 827.4 | 964.6 | 1,067.9 |
| B. Outflow | 722.9 | 1,043.7 | 1,119.4 | 1,291.4 | 1,418.0 | 1,382.7 |
| C. Balance | -80.6 | -372.2 | -551.9 | -464.0 | -453.4 | -314.8 |
| Oil-producing countries | | | | | | |
| A. Inflow | 81.0 | 109.0 | 80.0 | 184.0 | 124.0 | 74.0 |
| B. Outflow | 715.0 | 709.0 | 674.0 | 730.0 | 675.0 | 561.0 |
| C. Balance | -634.0 | -600.0 | -594.0 | -546.0 | -551.0 | -487.0 |
| Asia and West Asia, total | | | | | | |
| A. Inflow | 436.9 | 271.2 | 135.0 | 159.0 | 189.5 | 200.1 |
| B. Outflow | 1,367.4 | 1,592.4 | 1,744.2 | 1,997.5 | 2,138.5 | 2,401.9 |
| C. Balance | -930.5 | -1,321.2 | -1,559.2 | -1,838.5 | -1,949.0 | -2,201.8 |

Table 42. Selected developing countries: current inflow of foreign direct investment and outflow of income on accumulated past direct investment, a/ by region, 1965-1970 (continued)

(Millions of dollars)

| Region | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 |
|---|---|---|---|---|---|---|
| Asia and West Asia (continued) | | | | | | |
| Non-oil producing countries g/ | | | | | | |
| A. Inflow..... | 131.0 | 95.2 | 60.0 | 94.0 | 116.5 | 180.1 |
| B. Outflow..... | 168.7 | 150.4 | 204.2 | 239.5 | 246.5 | 235.9 |
| C. Balance..... | -37.7 | -55.2 | -144.2 | -145.5 | -130.0 | -55.8 |
| Oil-producing countries h/ | | | | | | |
| A. Inflow..... | 305.9 | 176.0 | 125.0 | 65.0 | 73.0 | 20.0 |
| B. Outflow..... | 1,198.7 | 1,442.0 | 1,540.0 | 1,758.0 | 1,892.0 | 2,166.0 |
| C. Balance..... | -892.8 | -1,266.0 | -1,415.0 | -1,693.0 | -1,819.0 | -2,146.0 |
| Selected developing countries, total | | | | | | |
| A. Inflow..... | 1,342.4 b/ | 1,215.4 | 1,074.0 | 1,372.0 | 1,513.6 | 1,612.7 |
| B. Outflow..... | 3,186.1 b/ | 4,063.9 | 4,246.2 | 4,982.6 | 5,155.8 | 5,341.8 |
| C. Balance..... | -1,843.7 | -2,848.5 | -3,172.2 | -3,610.6 | -3,642.2 | -3,729.1 |
| Non-oil producing countries, total | | | | | | |
| A. Inflow..... | 906.8 | 841.4 | 689.0 | 975.0 | 1,127.6 | 1,290.7 |
| B. Outflow..... | 940.9 | 1,247.9 | 1,380.2 | 1,588.6 | 1,720.8 | 1,678.8 |
| C. Balance..... | -34.1 | -406.5 | -691.2 | -613.6 | -593.2 | -388.1 |
| Oil-producing countries, total | | | | | | |
| A. Inflow..... | 435.6 b/ | 374.0 | 385.0 | 397.0 | 386.0 | 322.0 |
| B. Outflow..... | 2,245.2 b/ | 2,816.0 | 2,866.0 | 3,394.0 | 3,435.0 | 3,663.0 |
| C. Balance..... | -1,809.6 | -2,442.0 | -2,481.0 | -2,997.0 | -3,049.0 | -3,341.0 |

Source: Centre for Development Planning, Projections and Policies of the Department of Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, Balance of Payments Yearbook (Washington, D.C.).

a/ All statistics - inflows and outflows - are expressed in gross figures.
b/ Excluding Algeria.
c/ Ethiopia, Ivory Coast, Malawi, Mauritius, Sierra Leone, Sudan, Tunisia.
d/ Algeria, Libyan Arab Republic, Nigeria.

Foot-notes to table 42 (continued)

e/ Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Surinam, Trinidad and Tobago.

f/ Venezuela.

g/ Indonesia, Israel, Lebanon, Philippines, Sri Lanka, Thailand, Republic of Viet-Nam.

h/ Iran, Iraq, Saudi Arabia.

Table 43. Selected developing countries: occurrence of clauses restricting exports in samples of foreign direct investment agreements

(Number and percentage)

| Country | Number of agreements in the sample | Number of agreements containing: Clauses limiting exports | Clauses prohibiting exports | Percentage of agreements including some restriction on exports |
|---|---|---|---|---|
| Bolivia[a/] | 21 | - | 19 | 90.4 |
| Colombia[b/] | 58 | 2 | 39 | 70.6 |
| India[c/] | 737 | 235 | 114 | 47.3 |
| Peru[d/] | 26 | 6 | 19 | 96.1 |
| Philippines[e/] | 182 | 24 | 22 | 25.2 |

Source: Centre for Development Planning, Projections and Policies of the Department of Economic and Social Affairs of the United Nations Secretariat, based on Junta del Acuerdo de Cartagena, C. Vaitsos, The Process of Commercialization of Technology in the Andean Pact (Lima, October 1971) and United Nations Conference on Trade and Development, Restrictive Business Practices (TD/122/Supp.1), pp. 42-46.

a/ Sample includes foreign wholly-owned subsidiaries in pharmaceutical, food and beverage and other non-specified industries, 1968-1971.

b/ Sample includes foreign wholly-owned subsidiaries and joint ventures in pharmaceutical and chemical industries, 1968-1971.

c/ Sample includes agreements with subsidiaries and foreign minority joint ventures in effect in March 1969.

d/ Sample includes foreign subsidiaries in pharmaceutical and other non-specified industries, 1968-1971.

e/ Sample includes agreements with subsidiaries and foreign minority joint ventures in effect in 1970.

# A Brief Look at the Multinational Corporation

## Introduction

1. Since the end of World War II, foreign direct investment has increased tenfold and, for the first time, has come to rival trade as the chief form of international economic activity. This extraordinary expansion reflects, for the most part, the evolution of a new economic institution -- the multinational corporation (MNC). Concurrently, a relatively few, large -- primarily US-based -- private corporations have gained sufficient power to exert a profound influence on traditional national economic institutions, patterns of economic activity, and national governmental policy options. The concentration of economic power and the ability of the MNCs to circumvent national controls has aroused considerable anxiety among a growing number of national governmental and private interest groups. While some of these anxieties reflect political attitudes, most are centered on real economic impacts of the MNC. This memorandum briefly describes the characteristics of the MNCs; examines their growth and present magnitudes in the world economy; and deliniates their primary impacts.

Summary

2. The MNC is a relatively new economic institution combining several economic characteristics in a single firm. All MNCs are involved to some extent in international production and marketing. They are for the most part large firms in which the world headquarters carries out global planning for the entire organization and maintains tight centralized control over all its activities. The emergence of the MNC -- occurring largely in the postwar period -- has been facilitated by a more stable international environment; the establishment of large, tariff protected, free trading areas; and more rapid international transportation and communication. Given this new world economic situation, traditional firm goals of spreading risks, maintaining or increasing market shares, and minimizing production costs led to a rapid growth of the MNCs.

3. The growth of MNCs is reflected in large part by the increase in the total book values of the world's foreign direct investment stock. Foreign holdings of US firms surpassed $78 billion by the end of 1970, and the foreign investments of non-US firms rose to over $66 billion. The growth in the first decade after the war was concentrated in increased activities by the multinational oil companies. Since then, however, MNC activities has shifted toward manufacturing and assembly operations, much of it in advanced countries.

4. MNCs, as a result of their rapid growth, have become a very important international economic institution. It is estimated that their foreign subsidiaries' sales are equivalent to one-third of the OECD countries' industrial output. They are directly responsible for about one-fourth of all industrial product trade flows. Moreover, they have even larger relative positions in certain countries and industries.

5. The pervasiveness of MNCs enable them to touch almost every facet of the world economy. They influence international commodity trade, increase international

investment, and have very significant impacts on short-term capital flows -- especially in times of international monetary uncertainty. MNCs also contribute significantly to the rapidity with which new technological developments are disseminated world-wide, increase world production, and speed the rate at which the world economy adjusts to changes.

6. In host countries, MNCs contribute to productivity by introducing new technology. They also increase employment and output in host areas. The balance of payments impact in host countries varies. In nearly all cases, the remitted profits from the subsidiaries to the parent company exceed over the long-run the amount of the initial capital inflow; however, the impact on host countries' trade balances varies with the nature of the MNC activities.

7. The assessment of source country impacts of MNCs is made difficult by a divergence between the private and social returns to their foreign operations. In private terms, MNCs undoubtedly increase their earnings as a result of their foreign operations. However, impacts on the source country as a whole are ambiguous. The source country can increase its tax revenue from MNCs' higher foreign earnings, but the non-taxation of unremitted profits and the tendency of MNCs not to remit all profits mitigate this gain. The transfer of technology abroad by MNCs probably undermines to some extent the source country's position in world markets. MNCs increase both capital outflows and profit remittances in source countries, but its impact on the trade balance is unclear, as is the MNC's employment impact, a controversial issue in the United States.

## Discussion

### Characteristics

#### The Identity of the MNCs

8. Central to a look at MNCs and their impact is an identification of what denotes an MNC. Clearly, not all firms are MNCs. Those with no foreign operations are not, as is the case with many firms having foreign operations. A MNC then is a variant of the traditional national firm that combines several characteristics which create its uniqueness.

9. One characteristic of MNCs is of course some operations in foreign countries. The extent to which different MNCs maintain foreign investment and activities varies, but in all cases the amount of foreign activities is sufficient to allow substantial international flexibility in production, sales, and capital flows. Most MNCs have operations in several countries, with over 170 US-based MNCs controlling subsidiaries in six or more.

10. MNCs are characterized by large firm size. As shown by Table 1, in the United States, MNCs are much larger than the average US firm. Moreover, within specific industries, those firms that are MNCs generally hold a dominant position in that industry, as seen in the tabulation below listing the percentage of sales of selected industries accounted for by MNCs of that industry.

| | |
|---|---|
| Motor vehicles and equipment | 85 |
| Drugs | 77 |
| Petroleum regining | 69 |
| Chemicals, except drugs | 60 |
| Rubber and plastic | 57 |
| Electrical machinery | 50 |

11. A third characteristic of MNCs is a greater tendency to be technology-intensive. US based MNCs invest 33% more of their global sales receipts in research and development than other large firms, and employ more scientists and engineers as a

percentage of their labor force. Although no similar data is available on non-US MNCs, it is probable a similar relation holds. For example, leading European firms in the areas of research and development, such as Farbwerke Bayer (German) in chemicals and drugs and SKF (Sweden) in machinery, engage in substantial multinational activities.

12. MNCs carry out long-term corporate planning and control of the firms' growth on a global basis. They do not view each subsidiary as a separate firm, but rather as an integral part of the world-wide operation. The goals and performance of each subsidiary are therefore secondary to the performance of the entire MNC, such that in the interest of maximizing global goals, particular subsidiaries often are charged with tasks not in their individual interest. For example, MNCs as a rule maintain centralized research facilities, usually in the source country, a fact that may inhibit the research efforts of individual subsidiaries.

13. MNCs, in their effort to maximize the goals of the entire organization, also maintain tight, centralized control over their world-wide operations. The need for centralized control is accented by the large degree of vertical integration of production across national borders that occurs in MNCs. Ford (US), for example, produces engines in Britain and Germany, transmissions in Germany, and Canada installs them in bodies produced in the United States, for sales in the United States and Canada. International Business Machines (US) produces computer sub-assemblies in several European countries and assembles them at centralized assembly plants. Thus, to insure steady and appropriately sized flows of components among subsidiaries, tight control over all operations is essential.

The Emergence of the MNC

14. Firms which combine these characteristics did not emerge in great numbers until after World War II, although foreign direct investments existed previously. There were several changes in the world economy that provided necessary conditions for a multinationalization of production to take place. The vacuum of production facilities and technology

in Europe, coupled with inflows of US aid, provided a natural pull to large US firms to invest there. The discovery of large reserves of low-cost oil in the Middle East brought operations of international oil to that area.

15. The stability imparted to the world economy by the Bretton Woods arrangements -- underlined by the return to convertibility of major European currencies in the late 1950s -- provided a more general incentive toward the emergence of MNCs. Formation of two large, prosperous free trade areas, but with tariffs on imports from outside the areas, provided a further inducement for non-trade area firms to install production facilities behind the tariff barriers. The rapid development of transportation and communication technology also contributed to the evolution of the MNC by greatly lowering the time-cost of coordinating operations in areas distant from the national headquarters.

16. Given these changes in the world economic order, several existing incentives led firms to foreign production. One major factor in the multinationalization of production has been responses by MNCs to threats to their foreign export markets. These threats, which are created by competition from local or third country firms that are closer to the market, are often met by establishment of production facilities in the market area. A second incentive that induces firms to become MNCs is to provide greater earnings stability. By being in several countries with production and sales facilities, MNCs guard against downturns in the economy of a single country. Thus, during the 1970-71 US recession, US-based MNCs counted heavily on their foreign operations for significant portions of their earnings.

17. A third incentive for multinational operations is it allows firms to reduce various tax and legal constraints; e.g., a US-based MNC can legally acquire a foreign competitor whereas US anti-trust laws might prevent the acquisition of domestic competition. The gaining of access to tariff protected

markets is also a major incentive for MNC growth; a factor of major significance in MNC investments in EFTA and the EC. Finally, many MNC investments occur to obtain low-cost factors of production, usually raw materials, as with oil, or labor.

The Growth of MNC's International Interests

18. The postwar growth of MNCs is reflected in large part by the increase in the total book value of foreign direct investments -- i.e., plant and equipment owned in one country by citizens of another. Foreign holdings of US firms rose from $7 billion in 1946 to over $78 billion by the end of 1970. Moreover, it is estimated that the foreign assets of non-US MNCs have grown from about $5 billion in 1946 to nearly $70 billion in 1970 -- about the same rate of growth as that of US-MNCs' foreign operations[1/] (see Table 2). Concomitantly, the number of MNCs have risen from a mere few at the end of World War II to more than 300. Ten are the largest MNCs in the world are tabulated below with their annual sales in billions of dollars.

| | |
|---|---|
| General Motors (US) | 18.7 |
| Standard Oil of New Jersey (US) | 16.6 |
| Ford (US) | 15.0 |
| Royal Dutch Shell (Britain/ Netherlands) | 10.8 |
| General Electric (US) | 8.7 |
| International Business Machines (US) | 7.5 |
| Philips (Britain/Netherlands) | 4.2 |
| Farbwerke Hoescht (Germany) | 3.0 |
| Nestle (Switzerland) | 2.3 |
| Pechiney (France) | 1.6 |

19. The growth in MNC operations has been characterized by a shift in industrial and locational preference. Most MNC

1. These foreign direct investment (FDI) figures overstate to a small extent the foreign operations of MNCs, since they include FDI by firms not properly classified -- largely because of less than world-wide coordination of operations -- as MNCs. However, since the operations of these non-MNCs are generally small in nature -- often only a sales office -- the figures shown can be taken as reasonable estimates of MNC operations.

operations existing at the end of World War II were in the extractive industries of less-developed countries (LDCs). In the first decade after the war the primary MNC expansion occurred in the petroleum sector, largely in the Middle East. Since then, however, MNC emphasis has shifted toward manufacturing and assembly facilities in advanced countries. Manufacturing's share of total US foreign direct investment rose from 33% in 1946 to 42% in 1970, while the share of the total directed to other advanced countries increased from 49% to 61% over the same period (see Table 3). A similar trend can be observed in the foreign direct-investment patterns of non-US firms. The rise in MNC manufacturing investment is especially concentrated in vehicles, chemicals, mechanical and electrical engineering, and electronics. Industries such as textiles, basic metals, and aircraft manufacture are only minimally involved in multinational production, even though they often substantially engage in international commodity trade.

20. As a result of the increased emphasis by all MNCs on investment in advanced countries, a large amount of MNC ownership and control now proceeds in both directions between two regions. The US ownership of investments in Europe at the end of 1970 was put at $21.6 billion; European investments in the United States were valued at $8.9 billion. Additionally, within Europe a large percentage of recent foreign investment flows has been intra-European: 32% of the FDI by the EC countries in 1965-69 was within the EC.

The Importance of the MNC

21. The rapid growth of MNCs has elevated them to an immensely important position on the world economic scene. Annual sales by subsidiaries of MNCs are estimated at more than $300 billion. The sales of US-based MNCs alone -- put at $160 billion per year -- are greater than the GNP of every Organization for Economic Cooperation and Development (OECD) country except the United States and Japan. Sales

by all MNC subsidiaries are equivalent to one-third of the OECD countries annual industrial production.[2/] Moreover, an increasingly large portion of world commodity trade is controlled by MNCs. In 1966, the latest year in which the data is available, sales by US-MNCs to their foreign affiliates totaled over $6.5 billion, or over 25% the total US non-agricultural exports in that year.

22. When MNC presence in particular regions or countries is examined, their position is revealed as just as dominant, if not more so. Foreign MNCs in Canada, for example, own [redacted] the assets of Canadian manufacturing enterprises. [redacted], their dominance of certain industries in certain regions or countries is still greater. For example, about 80% of the European computer market is controlled by foreign MNCs, the entire Belgian output of automobiles comes from foreign MNC-controlled plants, and 85% of the French carbon black industry is foreign controlled. Table 4 presents the percentage of selected industries in various regions controlled by MNCs.

The Global Impact of the MNC

23. As the magnitude and pervasiveness of MNCs have grown, so have their impacts in the world economy. MNCs have affected most facets of the world economic system, by influencing trade flows, increasing capital mobility, speeding the processes of adjustment, affecting world and regional income and competitive conditions, and aiding the dissemination of new technology.

Trade Flows

24. MNCs have two primary, and counteracting, effects on world trade flows. On the one hand, the movement of the production facilities supplying a given foreign market from the source

2. The OECD countries include most of the advanced countries in the world. They are: the United States, the United Kingdom, Belgium, West Germany, Luxembourg, Netherlands, Italy, Sweden, Norway, Iceland, Denmark, Ireland, Canada, Austria, Portugal, Spain, [redacted] Switzerland, Japan, Australia, New Zealand, France, Greece, Turkey, Finland.

country to that market displaces the trade in finished goods between the two countries as the goods begin to be produced by the new subsidiary in the market they are sold. On the other hand, the establishment of production facilities in a particular market may create or maintain a demand for the products that would not otherwise occur; an example of which are the US-MNCs automobile plants in Europe. To the extent this production uses components produced in the source country of the investment trade flows are generated.

25. MNCs also have other impacts on world trade. The initiation of new or expanded operations in a host country almost always involves flows of capital equipment, generally from the source country, though sometimes from third countries. The higher host area incomes generated by MNC operations induce increased imports to that area. The changes in host area's competitiveness induced by transfers of MNC technology and by certain marketing externalities associated with MNCs also have impacts on the direction of world trade.

Capital Movements

26. Although a major role of the MNC is the international transfer of real capital -- e.g., capital equipment, managerial talent, etc., it also has a significant impact on international flows of financial capital. In a longer term context the development of the MNC has probably led to increased flows of long-term capital to finance the real capital flows. Most of the flows are from the source to the host country. During the last half of the 1960s, US FDI abroad increased 11% annually. However the tendency of MNCs to use debt financing in many investments has also led, especially in Europe, to the tapping of international credit markets. Both US and European MNCs have, for example, made extensive use of the Eurobond market (see Table 5).

The increased international investment by MNCs has also resulted in increased internationalization of ownership and accompanying higher inter-country flows of profits.

Profits remittances to the United States and United Kingdom, the leading source countries, increased at rates of 12% and 9%, respectively in the last half of the 1960s.

28. MNCs also have a major impact on the short-term capital market, especially during periods of international currency speculation. Payments for the many routine international trade transactions undertaken by MNCs entail substantial short-term capital flows from one country to another, but these flows, to a large extent, are offsetting through payments being made in opposite directions. Nevertheless, in times of currency upheaval, to hedge against possible exchange-rate adjustments, MNCs move out of weak currencies and into strong ones. At these times, the short-term flows generated frequently are massive. It is estimated that US and foreign-controlled companies in the United States transferred abroad over $10 billion in short-term funds in 1971. Furthermore, a major portion of the inflow of funds that percipitated the Deutschemark float of May 1971 were the result of MNC Eurodollar sales.

World Output

29. The effect of MNCs on the level of world output has undoubtedly been beneficial. They have on an international scale combined factors of production such as labor, capital, technology, and managerial ability in a manner that has reduced the costs of production and led to increased output. This role is of particular importance in cases where trade barriers have prevented commodity trade from achieving a full international rationalization of production. For example, because of technological leads, it is probably relatively more efficient for International Business Machines (US) to produce computers for use in Europe. However, EC tariff barriers prevents the import of IBM computers at reasonable price levels, thus lowering world computer production. But, by exporting capital, technology, and skilled manpower to Europe and producing computers there, MNCs are able to regain part of the output lost as a result of tariff barriers.

30. The impact of MNCs on world competition is more ambiguous. On the one hand, it appears that MNC operations have contributed to increased competition by their investments in certain countries or regions, such as in Britain in the tire and detergent industries. However, on a more global scale, there is some evidence that MNCs may have inhibited competition. This is especially likely in the oil industry, where highly integrated and capital intensive production process and the control of all major sources of crude by a few multinational oil firms have created an oligopoly structure in the world oil industry.

Dissemination of Technology

31. MNCs have played a major role in the dissemination of new technological innovations throughout the world. Prior to the advent of the MNC and their inte ational operations, new developments in technology were transmitted internationally relatively slowly. Usually the form of transmission took the form of licensing or embodiment in end products. However, MNCs fairly quickly install new innovations directly throughout their worldwide operations, thus shortening the time needed for a new innovation to be installed world-wide. Moreover, the technology in host countries contributes to the speed of imitation and adoption of the original innovation.

Speed of Adjustment

32. MNCs have contributed to an increase in the speed of response to changes in conditions in international markets. Most obviously in the short-term capital market, the speed and magnitude of flows that can be generated by MNCs have drastically shortened the length of time a disequilibrium position can continue. Moreover, it also appears as though MNCs have increased the rate of response to changes in other markets. They are able to quickly alter the value of trade flows in response to changes in tariffs, etc. by altering transfer prices,[3] and their sophisticated financial departments enable them to quickly take advantage of changes in interest rates.

Host Country Impacts

33. The expansion of MNC operations has led to several impacts on host countries. The impacts of course vary from country to country depending on the nature of the MNC investment, but some delination of the general impacts are possible. The most controversial impact is on the ability of host country governments to implement policies, while other impacts are on levels of technology, balances of payments, and income and employment levels.

34. In most cases, MNCs tend to limit the extent to which host country governments can implement national policies. Through their diversified international options MNCs can avoid dependence on the economy of any single country and thereby often circumvent the controls of individual national governments. To illustrate, because Ford-Germany is only a small

3. Transfer prices are set by the world headquarters and are prices at which intra-firm transfers are made. Because of their relative insulation from the market, MNCs can alter their transfer prices to change trade valuations for purposes of minimizing the tariff cost and shifting profits within the MNC.

part of Ford-US's international operations, attempts to influence the former's actions by the German Government could meet with less success than would the same attempts directed at strictly German firms. Of equal importance is the often conflicting goals of MNCs and nations. The MNCs tend to view their objectives and operations from a world-wide perspective while nations are concerned primarily with their individual welfare. This dichotomy often leads to actions by MNCs that are undesirable from the standpoint of specific countries, as exemplified by choices of MNC to move a production plant from one country to another.

35. The transfer of technology to subsidiaries by MNCs has directly aided productivity in host countries. Spinoffs to other industries and firms probably have indirect, but not insignificant, impacts on host country productivity. Moreover, the transfer of skilled manpower, especially at the managerial level, generally benefits production processes in host countries.

36. The extent to which the process of technology transfer is a benefit depends on the technology transferred and on the readiness of the host country to receive it. Thus, in many LDCs there are probably few spinoffs from a transfer of technology because there are no firms capable of making use of the technology. On the other hand, countries and firms with some technological expertise are able to readily adapt and use the spinoffs from the MNC. In the past, this latter group has been primarily European countries and firms.

37. The impact of MNCs on host country balances of payments varies. On the one hand, they contribute positively to host balances of payments through capital inflows, on the other hand, the remittance of profits to the parent company has an adverse impact. The impact on trade balances vary according to the nature of the investment. MNC operations to exploit deposits of natural resources -- such as the oil reserves in the Mid East -- generally increase host country

exports, while raising imports by a smaller amount. MNC production in a host country for sale in that country alternatively raise or lower exports as the production tends to retard or generate trade flows (see paragraph 24). Finally, MNC production which is sold outside of the host country -- 20% of all US-MNC subsidiary sales are outside of the host countries -- tend to increase component imports but increases exports of finished goods by a greater amount, usually the amount of the value added in the host country. MNC activities in East Asia and/along the US-Mexican border, which produce primarily for export, are examples of this latter type.

38. MNC subsidiary operations have a decidedly positive impact on host country employment and income. It is estimated that MNCs employ upwards of 5 million persons in host countries. Although some MNC operations substitute for employment creation by host country firms, in most cases MNCs generate employment opportunities, especially in LDCs where the domestic job-creating capability is limited. MNCs generate host country incomes by wage and salary expenditures, purchase of host country goods and services, and through increased government expenditures made possible by tax revenues from MNCs.

Source Country Impacts

39. The assessment of MNCs impact in source countries is complex. The impact in the terms of reference of the MNCs is undoubtedly positive; i.e., the net, after foreign and source country taxes, increase in earnings more than offsets the costs of the foreign investments. However, the impact in the terms of reference of the entire source country is not so clear.

40. The source country benefits from taxes on the remitted foreign earnings of MNCs as well as from the earnings themselves. However, to the extent that MNCs do not remit earnings to the source country, and that the source country taxes only remitted earnings, the gain to the source country is mitigated. Most countries (including the United States) do

not tax unremitted earnings, and most MNCs remitt only about 50% of their subsidiary earnings.

41. MNCs contribute to losses in technological leadership of the source country by their technology transfers. In the case of the United States, for example, it is highly likely that technological transfers by US-based MNCs have contributed to a more rapid rate of growth of technology abroad.

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During the last part of the 1960s, productivity growth in Europe outstripped that in the United States by 2 to 1 while that in Japan was 5 times higher. The percentage of US patent application filed by foreigners rose from 22% to 32% of the total.

42. MNCs also have impacts in the source country on balances of payments. They raise inflows of profit remittances and capital outflows. Their impact on trade flows is at present an undecided question. The direction in which the establishment of foreign subsidiary production -- as opposed to exporting to serve a foreign market affects the trade balance depends on what would have occurred in the alternate situation. If exporting is assumed to be a viable alternative, then the institution of foreign production replaces exports and harms the trade balance. However, if it is assumed that because of lower costs abroad foreign competition would take over the market, the foreign investment acts to preserve the trade balance.

43. Closely related to the impact of MNCs on the source country trade balance is its affect on employment, for if MNCs lower exports, they adversely affect employment. If they raise or preserve exports, employment is benefitted. This issue, the most controversial aspect of the MNC in the United States, is also unresolved. Undoubtedly MNC foreign operations displace, on a sectoral basis, some US jobs, but it is not clear if the long-run over-all impact is negative.

Table 1
Size Measures of US-MNCs and other US firms

| | 187 MNCs | non-MNCs on Fortune 500 | other US manufac turing enterpris |
|---|---|---|---|
| Sales per firm 1964 millions of dollars | 927.3 | 283.4 | 1.0 |
| Employees per enterprise 1964 | 35,800 | 11,500 | 38 |
| Plants in US per enterprise, 1964 | 76 | 34 | 1.5 |

Table 2
Estimated Worldwide FDI Stock at the end of 1970, Classified by Source Country
(billions US$)

| Source Country | FDI Stock |
|---|---|
| United States | 78.2 |
| United Kingdom | 22.7 |
| France * | 10.0 |
| Switzerland ** | 5.8 |
| West Germany * | 5.6 |
| Netherlands * | 6.1 |
| Canada | 4.9 |
| Italy * | 3.4 |
| Sweden | 2.3 |
| Belgium * | 2.2 |
| Japan | 1.7 |
| South Africa *** | 1.2 |
| Australia | 0.6 |
| Portugal | 0.1 |

* Totals for FDI by the European Community countries include cross-frontier investments within the Community

** A significant, though undetermined portion of the FDI credited to Switzerland actually originates in other countries and merely transits through Switzerland, largely for tax purposes

*** Excludes investment in South West Africa

Table 3
US FDI, by percentage shares
of industries and areas, selected post-war years

| | 1946 | 1957 | 1965 | 1979 |
|---|---|---|---|---|
| **(a) Industries** | | | | |
| Manufacturing | 33 | 32 | 39 | 42 |
| Petroleum | 19 | 36 | 31 | 28 |
| Mining/Smelting | 11 | 9 | 8 | 8 |
| Other | 37 | 23 | 22 | 22 |
| Total | 100 | 100 | 100 | 100 |
| **(b) Areas** | | | | |
| Canada | 35 | 34 | 31 | 30 |
| Latin America | 43 | 32 | 19 | 20 |
| Europe | 14 | 16 | 28 | 31 |
| Other | 8 | 18 | 22 | 19 |
| Total | 100 | 100 | 100 | 100 |

Table 4
Sales of Subsidiaries of US-MNCs, as a percentage of total, Selected Countries and Industries

| | food products | paper products | chemicals | rubber | primary metals | non-elec. machinery | elec machi. |
|---|---|---|---|---|---|---|---|
| Canada | 22 | 43 | 50 | 72 | 25 | 100 | 69 |
| Latin America | 8 | 18 | 28 | 58 | 20 | - | - |
| UK and Europe | 3 | 1 | 6 | 13 | 2 | 10 | 9 |

| | transport equipment |
|---|---|
| Canada | 100 |
| Latin America | - |
| UK and Europe | 13 |

Table 5
Euro-bond Issues by Category of Borrower, 1967-71
(Billions $)

| | 1967 | 1968 | 1969 | 1970 | 1971 |
|---|---|---|---|---|---|
| US companies | 562 | 2096 | 1005 | 741 | 1090 |
| Other companies | 575 | 603 | 817 | 1065 | 1119 |
| State enterprises | 442 | 349 | 682 | 594 | 838 |
| Governments | 303 | 500 | 584 | 351 | 479 |
| International Organizations | 120 | 25 | 68 | 215 | 98 |
| Total | 2002 | 3573 | 3156 | 2966 | 3624 |